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ECONOMIC ALERT

MPS — AUGUST 2019

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"The Official Cash Rate (OCR) has been reduced to 1.0 percent."

Why …

"A lower OCR is necessary to continue to meet its employment and inflation objectives"

Because ...

"Growth headwinds are rising."

And ...

"Global economic activity continues to weaken, easing demand for New Zealand's goods and services."

And ...

"The balance of risks to achieving its consumer price inflation and maximum sustainable employment objectives was tilted to the downside."

And ...

"In the absence of additional monetary stimulus, employment and inflation would likely ease relative to our targets."

And ...

"A lower OCR is necessary to continue to meet its employment and inflation objectives."

In conclusion …

"The members debated the relative benefits of reducing the OCR by 25 basis points and communicating an easing bias, versus reducing the OCR by 50 basis points now … The larger initial monetary stimulus would best ensure the Committee continues to meet its inflation and employment objectives."

Looking ahead …

"The lower OCR path reflected the economic projections and the balance of risks.

Market Implications

The Reserve Bank's Monetary Policy Committee ("MPC") stunned markets with an unexpected 50 basis points OCR cut. After solid labour market data and despite a sharp drop in surveyed inflation expectations in the days ahead of the MPC meeting, market expectations had squarely settled on a 25 basis points OCR cut.

Not surprisingly, the much larger than expected OCR cut caused the New Zealand dollar and local swap rates to plummet.

Comment

The Reserve Bank has well and truly joined the global central bank 'doom and gloom' bandwagon.

Even the Reserve Bank's official forecasts and assumptions had OCR cuts of 25 basis points today and in February. Just as in the May *Monetary Policy Statement* ("MPS"), the MPC went beyond the official assumptions.

On more than one instance in today's MPS, the Reserve Bank commented on the value of the New Zealand dollar with the inference that the Reserve Bank would like a lower Trade Weighted Index, which has been delivered.

There is little forward guidance but, based on the May MPS and subsequent events, an even lower OCR may be necessary to achieve inflation goals, resulting in even lower domestic swap rates and a lower TWI in time.